



OXFORD ANALYTICA

INDIA

FISCAL TRANSPARENCY

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INDIA



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	<i>2005</i>	<i>2004</i>	<i>2003</i>	<i>2002</i>
Clarity of roles	••••	•••	•••	•••
Availability of information	••••	••••	••••	•••
Budget preparation	•••	•••	•••	••
Accountability	•••	•••	•••	•••
Score	3.50	3.25	3.25	2.75

OUTLOOK & COMMENTARY

India has made several improvements in the area of fiscal responsibility at the state level. Adoption of the recommendations of the Twelfth Finance Commission will make states more accountable. In particular, states must produce annual statements on fiscal strategy with explicit targets for revenues and reducing fiscal deficits, which will dramatically enhance transparency. Legislation for the 2003 Fiscal Responsibility and Budget Management Act has been passed in a further ten states, and all states are expected to pass this Act by end 2005.

A new VAT system has been introduced in the majority of states this year with some success. The remaining states are expected to follow next year. This simplifies the tax system, but there is still a need to widen the tax base and reduce tax evasion. Coordination for fiscal data gathering should improve with the creation of a National Statistics Organisation, although concerns as to the quality of state level fiscal data remain. Initial steps have been taken to move to an accrual accounting system, although it will be some years before it is fully implemented. Analysis of fiscal risks remains underdeveloped in the budget documents. Implicit guarantees remain unspecified, although there are plans to include them in next year's budget. Information on the quasi-fiscal activities of public sector units (PSUs) remains inadequate.

EXECUTIVE SUMMARY

3.50 Enacted

Many states in India have been in the habit of spending more than their revenues, and so requiring constant handouts from the centre. This year, however, steps have been made to reduce state revenue deficits and debt while increasing accountability. The 2004 Report of the Twelfth Finance Commission makes recommendations to strengthen devolution to the states and provide incentives to make them more fiscally responsible. Each state must now pass a Fiscal Responsibility Act promising, among other items, to eliminate revenue deficit by 2008-9, reduce their fiscal deficit to 3% of Gross State Domestic Product (GSDP) and bring out annual statements on fiscal strategy with explicit targets for revenues and reducing fiscal deficits. Debt write-off is conditional on the reduction of a state's revenue deficit.

The 2003 Fiscal Responsibility and Budget Management (FRBM) Act, introduced for central and state governments, also progressed this year with a further ten states passing the Act, making a total of 15 out of 28 states. There is confidence that the remainder will follow by the end of 2005. The FRBM Act is designed to introduce fiscal discipline and transparency to the central government budget process and to restore fiscal sustainability by limiting central government borrowing and debt accumulation.

Up until this year, state tax rates on commodities were not harmonised across states and existed on top of the central taxes. This created a highly complex tax structure. A new VAT package was designed to eliminate these discrepancies while also increasing revenues and the tax base, and providing a base for wider reforms. At the start of the fiscal year, on 1 April 2005, 21 states out of a total of 28 introduced VAT. The remainder have either joined later or will most likely join in 2006. In the VAT-compliant states, VAT is working well with revenues increasing by some 15% although some states are performing better than others. Monitoring and collection are the next priorities. Although substantial progress has been made this year, there is still a need to widen the tax base, and reduce tax evasion.

The first steps have also been taken to move from cash accounting to an accrual-based system of accounting with pilot programmes in two line ministries, although this will take some years to implement fully.

Despite these advances, some areas remain in need of improved transparency. Quantification and analysis of fiscal risks remains underdeveloped in the budget documents. Implicit guarantees remain unspecified, although there are plans to include them in next year's budget. Information on the quasi-fiscal activities of public sector units (PSUs) remains inadequate.

The government approved the formation of the new National Statistics Organisation this year, which will replace the Central Statistical Organisation (CSO). Although better co-ordination between states and the CSO has resulted in some improvements in fiscal data this year, concerns about its quality and reliability remain, particularly at the sub-national level. Concerns over accounting and auditing are most serious at the state and local levels, mainly due to lack of capacity.

India's overall score has improved from 3.25 in 2004 to 3.50

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES

●●●● Compliance in progress

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions, and responsibilities of government

India, with a population of over one billion people, is a federation of 28 states and seven union territories. The structure and functions of the Indian federal system of government are set out in the Constitution of India. The basic law divides the government into union, state, and local levels and assigns specific functions to each level. It also establishes a list of responsibilities to be undertaken concurrently by the union and states.¹ Matters of national significance, such as defence, external trade, external borrowing, and federal public services and pensions are assigned to the centre. Functions with statewide implications, such as law enforcement, agriculture, and state public services are assigned to the states, while key development functions, such as economic planning, education, and social security are performed jointly by the union and states.²

Two key institutions influence fiscal relations between the centre and the states. These are the constitutionally-mandated Finance Commission, which convenes every five years to determine the sharing of revenues between the centre and the states, and the Planning Commission, which is charged with developing the national five-year plan and approving state-level annual plans, including the states' borrowing plan.

In practice, the fiscal system is weakened by the asymmetry between expenditure responsibilities and revenue-raising powers, particularly at the local (*panchayat*/municipal) level. As such, state and local governments depend on the transfer of resources from the centre for a large part of their revenues. These are executed through a number of government agencies, which makes it difficult to trace the flow and use of funds throughout government. According to the Eleventh Finance Commission, appointed in 1998 to review Indian finances until 2005, the 'most serious flaw in the current system of federal transfers is the flow of the centre's revenue to the states in segments through the Finance Commission, transfers through the Planning Commission, transfers to implement centrally sponsored schemes, and other discretionary transfers.'³

This year, steps have been taken to reduce state revenue deficits and debt. The Report of the Twelfth Finance Commission, November 2004, specifies a number of recommendations designed to give states a greater incentive to enact the FRBM. They aim to strengthen devolution to the states and provide incentives to make them more fiscally responsible. Each state must now enact a Fiscal Responsibility Act promising to eliminate revenue deficit by 2008-9, reduce their fiscal deficit to 3% of Gross State Domestic Product (GSDP) and produce annual statements on fiscal strategy and economic prospects with targets for revenues and reducing fiscal deficits. (Statements are due out in February 2006.) Debt write-off is conditional on the reduction of a state's revenue deficit. States are also required to provide the centre with detailed info on the number of salaried employees, and salary levels, in the public sector. The IMF is aiding states to improve reporting on fiscal and debt data. One of the Twelfth Finance Commission recommendations, an independent loan council to monitor and improve cooperation with states, has not yet been set up although it is likely to be established next year. It will supervise the overall limits of annual borrowings of state governments from all sources and may announce the borrowing limits of each state, taking into account sustainability

considerations. Commentators say that these recommendations have been taken far more seriously than those of previous Finance Commissions.⁴

Coordination and management of budgetary activities

A key change in India's budgetary framework has been the introduction of the Fiscal Responsibility and Budget Management (FRBM) Act in July 2003, together with the related Fiscal Responsibility Acts (FRAs) at the central government and state levels. The FRBM Act is designed to introduce discipline and transparency to the central government budget process and to restore fiscal sustainability. Its purpose is to make debt management consistent with fiscal responsibility by limiting central government borrowing and debt and deficit accumulation. Fiscal policy is to be conducted in a medium term framework. In 2004, the government finalised rules to implement the FRBM Act. The Act does allow the government to delay the targets in exceptional conditions with parliamentary approval.

At the state level, India has opted for an 'autonomous' approach for the adoption of FRBM, meaning that such legislation is not imposed by the centre on the regions but developed independently by each sub-national entity. Common features include quantitative and time-bound targets on the revenue and fiscal deficit, at least bi-annual reporting requirements, and a requirement that governments produce multi-year budget forecasts in line with these targets. Currently, 15 out of the 28 states as well as the central government have passed FRBM Acts and there is confidence that the remainder will follow by the end of 2005.⁵ In addition, the recommendations of the Twelfth Finance Commission must be incorporated into each state's (enacted) FRBM legislation before the Ministry of Finance will consider rescheduling debt.⁶

The Ministry of Finance (MoF) is responsible for formulating, executing and monitoring the union budget, as well as fiscal relations with state governments. Budgetary items are divided into a central government 'consolidated fund' for authorised revenues and expenditures, a central government 'contingency fund' for emergency expenditures, and a 'public account' for trust fund transactions that include small savings schemes and provident funds for government employees.⁷ This year, a standardised definition of revenue and fiscal deficits, and uniform classification of budgetary data is to be issued by the government to all states.⁸

The government tends to make fiscal corrections to the budget during the year depending on the economic situation. For example, in 2004 the government resorted to fiscal and monetary measures to control inflation originating from volatility of global oil prices. However, mid-year tax hikes have been discontinued.⁹

Relations between government and public sector agencies

As the manager of the government debt, the Reserve Bank of India (RBI) is allowed to participate in the primary market for government securities, although it ceased in 1997 to automatically monetise fiscal deficits through ad hoc T-Bills. Today, the RBI organises auctions for the primary placement of government securities. The FRBM Act prohibits the RBI from subscribing to primary issues of central government securities, effective from 2006-2007, except in exceptional circumstances as determined by the government and parliament. Commentators disagreed on the desirability of separating the RBI's debt management function from its monetary role. Some argued that such an institutional separation would improve fiscal and monetary transparency in India, while others claimed that the conflicting objectives of debt management and monetary policy would still remain despite the separation.¹⁰

The non-financial public enterprise sector remains substantial, with public utilities and public sector units (PSUs) playing a major role in the Indian economy. PSUs undertake a wide range of activities and many receive substantial subsidies with significant fiscal implications. The largest explicit subsidy is for the power sector, though large implicit subsidies are also provided for irrigation, higher education, and public transport.¹¹ The heavy subsidisation of public services, such as transport and electricity, through PSUs is not explicitly identified in the budget.¹²

Since early 2004, the government has used initial public offerings (IPO) to meet disinvestment targets with some success -- its IPO for the National Thermal Power Corporation (NTPC) was over-subscribed by 12 times the offer size. The government recently put forward a proposal to disinvest a minor stake in 'non-navaratna' (or small) PSUs, leaving only the nine largest. At a general level, it is also trying to crackdown on PSU financing from state-owned banks through special financing vehicles, a practice which hinders fiscal transparency. A Board for Reconstruction of Public Sector Enterprises (BRPSE) was formed this year to advise the government on measures to be taken to restructure PSUs, including cases where disinvestments, closure or sale is justified. However, it is not clear how active BRPSE has been so far. The PSU department in the Ministry of Heavy Industries produced an internal study on PSUs and this may be used as a framework for the operations of the BRPSE. Next year's budget will report on progress.¹³ Meanwhile, most state governments have launched restructuring programmes for their public enterprises; state governments have more often chosen to close rather than privatise state enterprises.¹⁴

The Department of Public Enterprises (DPE) presents to parliament every year a *Public Enterprise Survey*, which provides a review of the financial and socio-economic performance of Central Public Sector Enterprises. The *Survey* covers only those enterprises and their subsidiaries in which the central government's holding in paid up share capital is more than 50%. The Advisory Group of the RBI, set up in 1999 to review India's compliance with international financial standards, identified quasi-fiscal activities at the union and state levels as a serious limitation on fiscal transparency.

Government involvement in the private sector

Relations between the government and the private sector are regulated by the constitution and sector-specific legislation. The government is improving the quality of state supervision and regulation of the private sector by establishing independent regulatory commissions in key sectors such as telecommunications, electricity and insurance. The Telecom Regulatory Authority of India (TRAI), State Electricity Regulatory Commissions (SERCs), the Insurance Regulatory and Development Authority (IRDA), and the Securities and Exchange Board of India (SEBI), have now been up and running for several years. Initially these were not effective as regulators, but improvements have been made this year. TRAI is now much more effective since its relationship with the Department of Telecommunications was clarified. SEBI has been given more powers through an amendment passed this year. However, it still lacks credibility in terms of being able to inflict penalties and its activities often overlap with the RBI's role in regulating banks. Work on improving the effectiveness of the IRDA will start as soon as a new Insurance Act is passed. A Competition Commission has also been established but it is currently locked in discussions about its role.¹⁵ There is still a need for major overhaul of the agriculture regulatory regime.

There should be a clear legal and administrative framework for fiscal management.

Legal framework for budgetary activities

The legal framework for budgetary activities is specified in Articles 112-117 of the constitution. The FRBM Act aims to create a framework of fiscal discipline through statutory constraints on spending by the centre. The FRBM Act requires the central government to take the measures necessary to reduce the fiscal and revenue deficits so as to eliminate the revenue deficit by 31 March 2009. Any deviations by the government from these targets require parliamentary approval. In addition, the central government is barred from borrowing from the central bank.¹⁶

To increase transparency in fiscal operations, the FRBM Act also requires that the government disclose any changes in accounting standards or in policies and practices affecting or likely to affect the computation of prescribed fiscal indicators. To increase compliance at the end of the second quarter of a financial year, the government must take corrective measures if total non-debt receipts are less than 40% of budget estimates, if the fiscal deficit is higher than 45% of the budget estimates, or if the revenue deficit is higher than 45% of the budget estimate.¹⁷ Although the rules

necessary to implement the FRBM Act came into existence in July 2004, in the government has been presenting quarterly and mid-year reviews to the parliament since 2003.¹⁸

Legal framework for taxation

The constitution assigns most progressive taxes, such as personal income tax (excluding agriculture), corporation tax, and customs and excise duties (apart from alcohol) to the central government. The major tax source for India's states are sales tax, stamp duties and registration fees, state excises on alcohol, and motor vehicles, goods, and passenger taxes. In practice, the states raise about 65% of their revenues from their own sources and the remaining 35% is transferred to them by the central government.

Tax administration in India is one of the most complex tax systems in the world, partly because of numerous taxes and refunds, and partly because tax powers are shared by the central and state governments. In 1994, a service tax was introduced, on top of the existing manufacturing tax. Since then, the scope of the service tax has widened (to add more services) and rates increased. The constitution has recently been amended to authorise the transfer of the authority to tax services from the central to state governments.¹⁹ Widening and deepening of the service tax is likely to reduce the level of tax evasion.²⁰

A government task force, set up to review indirect taxation, recommended replacing central excise duties with a value added tax (VAT) in its final report, submitted December 2002.²¹ The task force also urged the imminent reform of India's tax system and a widening of the tax base to prevent a further decline in the ratio of indirect tax to GDP.²² Up until this year, state tax rates on goods and services were not harmonised across states and existed on top of the central sales and central excise tax. This created a highly complex tax structure. A new VAT package was designed to eliminate these discrepancies while also increasing revenues and the tax base, and providing a base for wider reforms. Initial attempts at introducing a VAT system failed due to problems with implementation at the state level and opposition from unions, but at the start of the fiscal year, on April 1 2005, 21 states out of a total of 28 introduced VAT. The state of Uttaranchal has recently introduced the full system too; another will join in January 2006 leaving three states ruled by the opposition, as well as Tamil Nadu and Uttar Pradesh still to join. It is likely that these remaining states will also introduce VAT in the new year too as there is tremendous pressure from industry in non-VAT compliant states to join as they are losing competitive advantage over industries operating in VAT compliant states.²³

The World Bank and the Asian Development Bank (ADB) have conducted training for states in implementing their VAT regimes. The ADB has also been working with some state governments in setting up systems for checking and monitoring tax payments. In the VAT-compliant states, VAT is working well with revenues increasing by some 15% although some states are performing better than others. Monitoring and collection are the next priorities.²⁴

The ADB is providing technical assistance to the government's efforts to improve tax administration and has also helped at the state level with the training of officers to help enforce VAT compliance. VAT revenues should help to cut borrowing, but further reforms are still necessary to reduce the bloated fiscal deficit. Successive budgets introduced some measures to improve tax administration, though tax exemptions are not really addressed. Although substantial progress has been made this year, there is still a need to widen the tax base, and reduce tax evasion.

Corruption is widespread in India, particularly in those areas of the tax administration where officials have discretionary powers over tax collection, such as customs. To make tax accounting more transparent and to reduce the opportunities for malfeasance, the government introduced an Online Tax Accounting System (OLTAS) in June 2004. Under the OLTAS, 15 offices of the RBI, and 11,699 authorised branches of 31 agency banks transmit daily data on income and corporate tax collected by them to the tax information network.²⁵ Initially OLTAS experienced some problems with misclassification of income tax, but it is now working well and the IMF will assess it in the coming months. It has also been useful for private corporations, assisting them with tax arrears. Commentators have

stated that the computerisation of tax collection and accounting had improved the transparency and efficiency of tax administration by reducing the interface between the tax collector and the payer.²⁶

Ethical standards for public servants

Statutory laws relating to the behaviour of civil servants and prescribing penalties for misconduct are in place. However, corruption is widespread, especially in areas where public servants have discretionary power. Most states have set up anti-corruption commissions, but they tend to remain weak and ineffective. Nevertheless, the anti-corruption commission in the state of Karnataka has been held up as one of the more successful bodies to fight corruption in the civil service.²⁷

2. PUBLIC AVAILABILITY OF INFORMATION



Compliance in progress

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Central government operations

India subscribed to the IMF Special Data Dissemination Standard (SDDS) in December 1996 and started posting its metadata on the IMF's Dissemination Standards Bulletin Board (DSBB) in October 1997. India's data reporting complies with the IMF SDDS. The government meets the specifications for coverage, periodicity, and timeliness in all data categories with two exceptions -- timeliness of data on general government operations, for which it takes a flexibility option, and periodicity and timeliness for the labour market, for which it takes 'as relevant' flexibility options. India formally launched a National Summary Data Page as prescribed by the SDDS in July 2003.²⁸

The *Union Budget*, which is published by the MoF and which is available online, lists budget estimates for the ongoing fiscal year and revised estimates and outturns for the previous nine years.²⁹ The original estimates are published in February every year, while the revised estimates, which contain revised revenue and expenditure targets and supplementary grants, are disseminated later. As a result of the FRBM Act, the MoF now publishes a medium-term fiscal policy statement, which includes a three-year rolling budget, with its annual budget submissions.

Information on contingent liabilities is provided in Annex Five of the *Expenditure Budget*, which lists all the explicit loan guarantees of the central government. Quasi-fiscal activities undertaken by PSUs are set out in the *Expenditure Budget* publication. These include subsidies allocated. Implicit guarantees, on the other hand, are not, as yet, fully reported, although their itemisation will be included in the next budget.³⁰ Some state governments have also begun to publish information about such guarantees in their budgets.

However, the restructuring of the Unit Trust of India, a public sector mutual fund, at the cost of some 3 billion US dollars (equivalent to around 1% of GDP) in September 2002 indicated the extent of the problem posed by some of India's largest public sector financial institutions to the union budget.

Under the FRBM Act, the central government is now required to submit before parliament three new fiscal statements:³¹

- A Medium-Term Fiscal Policy Statement, which sets out a three-year rolling target for prescribed fiscal indicators, including specification of underlying assumptions;
- A Fiscal Policy Strategy Statement, which contains the central government's policies for the ensuing financial year in the areas of taxation, expenditure, market borrowing, and other liabilities; the government's strategic priorities for the ensuing financial year; key fiscal measures and the rationale behind any major deviation in fiscal measures; and an evaluation of how the government's current policies are consistent with the fiscal management principles of the FRBM Act and the Medium-Term Fiscal Policy Statement; and

- A Macroeconomic Framework Statement, which contains an assessment of the growth prospects of the economy and specifies the underlying assumptions.

Public sector operations

Data on general government or public sector operations are compiled by the RBI and published in the RBI's *Annual Report* and *Report on Currency and Finance*. Public sector data is disseminated on total expenditure (broken down into development and non-development spending), current revenues (broken down into tax and non-tax revenues), the balance (deficit/surplus), and financing (broken down into domestic and external sources). The data is recorded on a cash basis and presented in a consolidated format. The consolidated fiscal position of the public sector is published in the RBI's *Handbook of Statistics* every December.

The central and state budgets are finalised sequentially, because states must wait for the approval of budget transfers from the centre before they can complete their budget. The first set of consolidated data for the public sector generally becomes available nine months after the end of the reference year. The RBI provides information on state budgets through its publication *State Finances: A Study of Budgets*. It also provides information on states' debt, borrowing, and guarantees. The MoF provides consolidated information on central and state government finances through its *Economic Survey* (released one day before the presentation of the union budget) and *Indian Public Finance Statistics*. Quasi-fiscal activities undertaken by state-level public institutions and enterprises, such as state electricity boards and road transport corporations, are detailed in state budgets.

An outstanding obstacle to the transparency of India's public sector operations, recently highlighted by the IMF, is that no single government unit has the authority and responsibility to compile and disseminate an integrated comprehensive statement of government finance statistics. The decentralised nature of the Indian government, combined with what appears to be deteriorating coordination among the agencies that produce the data used for national accounts, also affect the quality of India's fiscal and economic statistics.³² Matters should improve with the formation of the new National Statistics Organisation, which will replace the Central Statistical Organisation (CSO). However, better co-ordination between states and the CSO has resulted in improvements in the compilation and timely release of fiscal data this year. In the coming years, continuing improvements in this area should see the time lag for the release of central and state level data reduce to one quarter.

In addition, revenue projections and budget targets at both the union and state levels tend to be inaccurate. 'Built-in optimism' of the forecasting process leads to imprecise revenue projections that are revised mid-year. The inaccuracy of revenue forecasts at the state level is also problematic. States tend to overestimate their revenue intake while underestimating the losses of state electricity boards and other PSUs.³³ According to the World Bank, for the five years ending 2002-03, budgeted revenue estimates at the state level exceeded actual revenues by an average of 8%.³⁴ However, this year improvements have been seen in revenue projections at the central level and the IMF has made presentations to aid the centre to improve further. At the state level, implementation of the Twelfth Finance Commission recommendations will help to improve revenue forecasts.³⁵ These improvements should help to increase public confidence in fiscal data.

The Right to Information Act, which came into effect in October 2005, grants the public the right to gain information on government activities and access records. Commentators believe this may help curb corruption and improve government accountability.³⁶ The Ministry of Finance website has consequently been updated to comply with the requirements of this Act and now includes all publicly available reports as well as outlining the roles and responsibilities of the Ministry.³⁷

A commitment should be made to the timely publication of fiscal information.

Debt reporting

The RBI is responsible for the publication of data on central government debt. Data are disseminated for central government debt, broken down into domestic and external debt, and further classified by debt instrument and currency. Data are also available for domestic and foreign debt, classified by maturity, and for debt guaranteed by the central government (that is, explicit contingent liabilities). These statistics are published quarterly and within one quarter of the end of the reference quarter. The Controller General of Accounts compiles the data.³⁸

The annual *Receipts Budget*, *Annual Economic Survey*, *Indian Public Finance Statistics*, and the RBI's *Report on Currency and Finance* are the main publications that report on central government liabilities in India. The MoF also publishes its annual *India's External Debt: A Status Report*, which includes debt service projections and central government guarantees of external debt raised by PSUs. Apart from annual publications, the MoF publishes quarterly external debt data with a three-month lag. Total outstanding loans to PSUs are listed in the *Public Enterprises Survey*, which is published by the Department of Public Enterprises, with a two-year lag.

India provides information on central government operations, central government debt, and general government operations. Data on central government operations is disseminated for revenue and capital receipts, plan and non-plan expenditure, deficit items, and fiscal deficit financing (broken down into external and domestic sources). The data are based on the actual accounting records of central government units and are recorded on a cash basis. These data are released monthly and within one month of the reference month.³⁹

Advance release calendars

The Controller General of Accounts disseminates an annual advance release calendar, which gives notice of the precise release dates for data on central government operations, debt, and public sector operations.⁴⁰

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING



Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

The objectives of fiscal policy are set out in the budget speech of the minister of finance, delivered in February each year. Policy objectives are defined for the fiscal deficit and for critical areas of expenditure in the upcoming fiscal year. The FRBM Act significantly improves the definition of fiscal objectives by mandating that the government present its fiscal priorities in an annual Fiscal Policy Strategy Statement, and evaluate them with specific reference to the FRBM Act and the Medium-Term Fiscal Policy Statement.

Macroeconomic framework

The FRBM Act requires that the government attach a Macroeconomic Framework Statement to its annual budget submission. The statement includes an assessment of the growth prospects of the economy and identifies the underlying assumptions of that assessment. The methodology for calculating revenues is now publicly available.

Fiscal risks

The budget documentation does not specify fiscal risks stemming from implicit contingent liabilities to public financial institutions such as the Unit Trust of India or uncertainty about privatisation receipts. The recent introduction of the Macroeconomic Framework Statement has not improved matters either since it lacks policy direction, does not give an indication of the impact of future policies on the fiscal situation, and does not quantify fiscal risks.⁴¹

Fiscal sustainability

The Medium-Term Fiscal Policy Statement mandated under the FRBM Act includes an assessment of fiscal sustainability.⁴² The FRBM Act, whose introduction was spurred by concerns over India's fiscal stability, provides for strict fiscal rules to reduce the fiscal and revenue deficits and to bring public debt down to a sustainable level. The government must set annual targets for the reduction of fiscal and revenue deficit, with the latter to be eliminated by 31 March 2009, although the targets may be delayed by the government 'on the ground or grounds of national security or national calamity or such other exceptional grounds as the central government may specify'.⁴³

Budget presentation

Data reporting

Budget data are recorded in gross terms and on a cash basis, in a manner consistent with the IMF's General Finance Statistics system. Government transactions are classified by administrative agency, economic category, and functions and programmes. In addition to this breakdown, the Indian budget also divides expenditures into plan and

non-plan spending. However, this distinction is not meaningful, as non-plan expenditure also includes expenditures left over from planned programmes.

Given the substantial expenditure powers of state governments, the public sector balance is the most reliable indicator of general government activity in India. However, this data is only published after a nine-month lag.⁴⁴ Reporting on public sector activity has improved this year, though, as large PSUs have begun compiling and releasing quarterly data.⁴⁵

Budget execution and monitoring

Accounting basis

The Controller General of Accounts (CGA) is responsible for government accounting in India, including the central government's transactions. It is also the principal accounts adviser to the central government and is responsible for establishing and maintaining a technically sound management accounting system.

The CGA prepares monthly analyses of expenditures, revenues, borrowing, and the fiscal balance for the minister of finance as well as annual *Appropriation Accounts* and *Union Finance Accounts* for presentation to parliament. These documents are compiled in accordance with the 1990 Government Accounting Rules and presented to the legislature after their statutory audit by the Comptroller and Auditor General (CAG). The provisional final accounts are generally available within three to four months of the end of the fiscal year.

The Report of the Twelfth Finance Commission recommends that the government move from the existing cash accounting system to a new accrual-based system (Recommendation No.68). The government has accepted this recommendation and asked the Government Accounting Standards Advisory Board (GASAB) to draw a detailed road map and an operational framework for implementation. The GASAB has received training and assistance from the World Bank and has selected two ministries in which to first introduce an accrual system. A Chart of Accounts is still to be drawn up and overall implementation is likely to take some years due to problems with the registration and current market valuation of assets and the old cash accounting system. However, fiscal transparency will undoubtedly improve as more progress is made.⁴⁶

Many states have now set up integrated treasury management systems, which help to monitor state treasury disbursements and improve cash management.⁴⁷

Procurement and employment

Procurement and employment regulations are clearly set out in relevant legislation. Tenders for contracts above a certain size are open to audits. While national legislation is firmly in place, India has not adopted WTO regulations on government procurement, which would require national treatment for firms from other WTO member states. Employment regulations require that vacancies be filled through competition, while senior appointments be vetted and approved by independent commissions.⁴⁸

At the sub-national level, states such as Karnataka and Tamil Nadu have undertaken initiatives to improve transparency in the procurement process. Others, including National Capital Territory of Delhi, Rajasthan, and Maharashtra have adopted legislation enshrining the public's right to information. Anecdotal evidence suggests that this procurement legislation has helped increase competition in tenders and has lowered costs in at least some states.⁴⁹

Fiscal reporting

Previously, there was no system of regular mid-year reporting, although supplementary budgets are submitted to parliament each July based on mid-year expenditure reviews. The supplementary budgets are discussed, debated and voted upon by parliament, though they usually receive less scrutiny than the original budget. Expenditure against these grants is examined and commented upon by the Public Accounts Committee of parliament after audit by the CAG. The FRBM has made quarterly budgetary reporting by the minister of finance mandatory. For example, as of the last budget, the government is now committed to releasing quarterly data on its Outcomes Budget. This budget significantly improves fiscal transparency as it lists exactly how funds have been spent. For example, rather than showing how much money has been spent on schools, the Outcomes Budget lists how many schools were built. The next stage is for each line ministry to publish its own Outcomes Budget, including non-plan expenditure.⁵⁰

The FRBM envisions mid-year budget reporting, and the first mid-year review was presented in parliament last year.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY



Enacted

Data quality standards

In general, India's macroeconomic statistics are consistent with international statistical recommendations. Monetary statistics broadly conform to the guidelines set out in the IMF *Monetary and Financial Statistics Manual (MFSM)*. National accounts and balance of payments statistics largely, but not entirely, follow the recommendations of the *System of National Accounts 1993 (1993 SNA)* and the IMF *Balance of Payments Manual*, fifth edition (*BPM5*) respectively.

However, there are some areas where quality could still improve. Concepts for government finance statistics are not fully consistent with the IMF *Manual on Government Finance Statistics 1986 (GFSM 1986)* and many linkages are not transparent.⁵¹ No plans are yet in place for implementing the compilation of government finance statistics according to the IMF *Government Finance Statistics Manual 2001 (GFSM 2001)* methodology. All official consumer price indexes compiled in India are for specific segments of the population and none represent a broad measure of general consumer price inflation.

In August 2001, the National Statistical Commission, which evaluated the Indian Statistical System, made 623 recommendations to be implemented by various central ministries and departments and the states to improve the quality of economic statistics. So far 231 of these have been implemented, and another 186 are in the process of implementation by line ministries and state governments.⁵² The Ministry of Statistics and Program Implementation is pursuing the remaining recommendations.⁵³

Independent scrutiny of fiscal information

Independent Audit

The Comptroller and Auditor General (CAG) is responsible for auditing the accounts of the central and state governments, PSUs, and major government organisations. The independence of the auditor general, whose status is identical to that of a supreme court judge, is guaranteed by the constitution.⁵⁴ The CAG undertakes both financial and performance audits. CAG reports are regularly reviewed by parliamentary bodies, such as the Public Accounts Committee and the Committee on Public Undertakings, and this intermediary mechanism between government departments and the auditor also allows for the consensual adoption of audit recommendations. Ministries are required to submit a report on the implementation of recommendations made by the auditor.⁵⁵

Audits at the state and local level remain problematic. While audit procedures are adequate on paper, they are neglected in practice.⁵⁶ The CAG also audits the accounts of state governments and CAG Reports are placed before the state legislatures and discussed by the State Public Accounts Committee (PAC) and the Committee on Public Undertakings. However, CAG recommendations are not followed strictly, fiscal discipline is lacking and PACs and legislative oversight authorities are also thought to be weak. Critics say there must be greater co-ordination between the CAG and the state authorities.⁵⁷ Many local governments do not produce accounts, let alone audits, and such procedures are hampered by the lack of computerised information in state treasuries. There is a need to modernise

state accounting systems. However, the situation should improve with the continuing implementation of FRBM when the CAG will be under pressure to ensure the production of more timely accounts.

National Statistics Agency

The Allocation of Business Rules of 1961 charge India's Central Statistical Organisation (CSO) with the responsibility for compiling the national accounts. A government commission evaluated the Indian Statistical System in 2001 and found that in certain areas coordination for statistical purposes has almost collapsed.⁵⁸ Consequently, it recommended the establishment of a permanent and institutionally independent national commission on statistics.⁵⁹ To improve matters, the World Bank is providing technical assistance in order to set up a National Statistics Organisation (NSO), which will bring together the existing Central Statistical Organisation (which works with ministry statistical departments and state governments) and the National Sample Survey Organisation. Although progress has halted due to bureaucratic resistance, a project has been completed on statistical reform and this will be evaluated by July 2006.⁶⁰

According to the IMF, India's macroeconomic statisticians display a high degree of integrity, and government statistical agencies are professional and have high ethical standards, as well as transparent policies and practices.⁶¹

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to India between 15 and 18 November 2005.

Ministry of Finance

16 November 2005

S. C. Pandey	Officer on Special Duty	Fiscal Responsibility & Budget Management
Anuradha Prasad	Director	Budget Division
V. Chenthil	Joint Secretary	

Reserve Bank of India (RBI)

18 November 2005

Michael Debabrata Patra	Advisor	Monetary Policy Department
Himanshu Joshi	Director	Monetary Policy Department
M.K. Sagar	Director	Monetary Policy Department

ADDITIONAL INTERVIEWS

15 November 2005

Michael Wattleworth	Senior Resident Representative	IMF
Renu Kohli	Senior Economist	IMF
Sudip Mohapatra	Economist	IMF

16 November 2005

Kapil Kapoor	Sector Manager-South Asia	World Bank
Mohan Naharajan	Senior Economist	World Bank
Ramesh Kolli	Deputy Director General	Central Statistical Organisation

17 November 2005

H. Mukhopadhyay	Economist	ADB
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NOTES

- ¹ The Constitution of India (1949);
- ² For more information on the division of responsibilities, see Constitution of India, 7th and 11th Schedule; Rajaraman, I., 'Fiscal Transparency', *Economic and Political Weekly*, Vol. XXXVI, No. 52, 29 December 2001, p. 4882.
- ³ *Report of the Eleventh Finance Commission (for 2000-2005)*, June 2000, Section 2.39, p. 13.
- ⁴ Interviews in India, 15-18 November 2005. See also *The State's Debt Consolidation and Relief Facility* at: finmin.nic.in/the_ministry/dept_expenditure/plan_finance/Fiscal%20Reforms%20Facility/Guidelines-DCRF.htm and *The Twelfth Finance Commission Report*, November 2004 at fincomindia.nic.in/Report%20of%2012th%20Finance%20Commission/12fceng.pdf
- ⁵ Interviews in India, 15-18 November 2005.
- ⁶ *The State's Debt Consolidation and Relief Facility* at: finmin.nic.in/the_ministry/dept_expenditure/plan_finance/Fiscal%20Reforms%20Facility/Guidelines-DCRF.htm
- ⁷ 'Department of Economic Affairs' and 'Key to Budget Documents, Budget 2002-2003', Ministry of Finance website, finmin.nic.in/; Constitution of India, Article 112.
- ⁸ Interviews in India, 15-18 November 2005.
- ⁹ Interviews in India, 5-7 October 2004.
- ¹⁰ Interviews in India, 8-14 October 2002; Reserve Bank of India Act (1934), Law Publishers India Ltd., Preamble, Chapter III, Sections 7, 20, 21, Chapter III-B, Section 45-JA, Chapter IV, Section 58; *Report of the Advisory Group on Transparency on Monetary and Financial Policies*, RBI, September 2000, pp. 15-16.
- ¹¹ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.28.
- ¹² *Report of the Advisory Group on Transparency on Monetary and Financial Policies*, RBI, September 2000, p. 17; *The States' Fiscal Reforms Facility (2000-2005)*, Ministry of Finance, p. 5.
- ¹³ Interviews in India, 15-18 November 2005.
- ¹⁴ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.34.
- ¹⁵ Interviews in India, 15-18 November 2005.
- ¹⁶ The Fiscal Responsibility and Budget Management Act, 2003.
- ¹⁷ The Fiscal Responsibility and Budget Management Rule, July 5, 2004.
- ¹⁸ Interviews in India, 15-18 November 2005.
- ¹⁹ Constitution of India, 95th Amendment.
- ²⁰ Interviews in India, 5-7 October 2004.
- ²¹ See indiabudget.nic.in/es2002-03/chapt2003/chap29.pdf
- ²² *Report of the Task Force on Indirect Taxation*, Ministry of Finance, October 2002, Section 8; Interviews in India, 5-7 October 2004.
- ²³ Interviews in India, 15-18 November 2005.
- ²⁴ Interviews in India, 15-18 November 2005.
- ²⁵ *Mid-Term Review of Monetary and Credit Policy for the year 2004-2005*, RBI, 26 October 2004, p.45.
- ²⁶ Interviews in India, 5-7 October 2004.
- ²⁷ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.37.
- ²⁸ Press Note, 'India: National Summary Data Page', Ministry of Finance (*India: Report on Observance of Standards and Codes (Data Module)*), IMF, April 2004, Annex A).
- ²⁹ Available at indiabudget.nic.in
- ³⁰ Interviews in India, 15-18 November 2005.
- ³¹ The Fiscal Responsibility and Budget Management Act, 2003.
- ³² *India: Report on Observance of Standards and Codes (Data Module)*, IMF, April 2004, p.11.
- ³³ *Report of the Advisory Group on Transparency on Monetary and Financial Policies*, RBI, September 2000, p. 52.
- ³⁴ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.37.
- ³⁵ Interviews in India, 15-18 November 2005.
- ³⁶ See Oxford Analytica Daily Brief: 'India: Information law grants important new rights', 21 October 2005
- ³⁷ Interviews in India, 15-18 November 2005.
- ³⁸ Dissemination Standards Bulletin Board (DSBB), IMF, dsbb.imf.org/
- ³⁹ Dissemination Standards Bulletin Board (DSBB), IMF, dsbb.imf.org/
- ⁴⁰ Controller General of Accounts website, cga.nic.in/
- ⁴¹ Interviews in India, 15-18 November 2005.

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- ⁴³ The Fiscal Responsibility and Budget Management Act, 2003, Article 4.
- ⁴⁴ IMF ROSC, 'India: Fiscal Transparency', Section III/32.
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- ⁴⁶ Interviews in India, 15-18 November 2005.
- ⁴⁷ Interviews in India, 15-18 November 2005.
- ⁴⁸ 'India has no plans to join WTO procurement pact', The Hindu, 6 August 2002; Reserve Bank of India Act (1934; *Report of the Advisory Group on Transparency on Monetary and Financial Policies*, RBI, September 2000, pp. 48-49.
- ⁴⁹ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.37.
- ⁵⁰ Interviews in India, 15-18 November 2005.
- ⁵¹ *India: Report on Observance of Standards and Codes (Data Module)*, IMF, April 2004, p.4.
- ⁵² Interviews in India, 15-18 November 2005.
- ⁵³ *India: Report on Observance of Standards and Codes (Data Module)*, IMF, April 2004, Response by the Authorities, p.2.
- ⁵⁴ Constitution of India, Part V, Chapter V, Article 148.
- ⁵⁵ IMF ROSC, 'India: Fiscal Transparency', Section D/26.
- ⁵⁶ *State Fiscal Reforms in India: Progress and Prospects*, World Bank, 10 November 2004, p.38.
- ⁵⁷ Interviews in India, 15-18 November 2005.
- ⁵⁸ *India: Report on Observance of Standards and Codes (Data Module)*, IMF, April 2004, p.10.
- ⁵⁹ Interviews in India, 8-14 October 2002.
- ⁶⁰ Interviews in India, 15-18 November 2005.
- ⁶¹ *India: Report on Observance of Standards and Codes (Data Module)*, IMF, April 2004, p.4.